

109 FERC ¶ 61,286
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;
Nora Mead Brownell, Joseph T. Kelliher,
and Suede G. Kelly.

PJM Interconnection, L.L.C.

Docket Nos. ER03-1101-001,
ER03-1101-002, ER03-1101-003,
ER03-1101-004, ER03-1101-005, and
ER03-1101-006

ORDER ON REHEARING AND COMPLIANCE FILINGS

(Issued December 20, 2004)

1. On October 7, 2003, as supplemented on May 26, 2004, PJM Interconnection, L.L.C. (PJM) submitted a filing in compliance with our order issued in this proceeding on September 22, 2003.¹ Clarification and in the alternative rehearing of the September 22 Order was also sought by Epic Merchant Energy, LP, SESCO Enterprises L.L.C., and Black Oak Energy, L.L.C. (Epic, *et al.*).² For the reasons discussed below, we will grant Epic, *et al.*'s request for rehearing and accept PJM's compliance filing subject to modification.

I. Background

2. On July 22, 2003, PJM proposed revisions to its credit policy based on its assertion that its then-existing credit requirements (which applied only to settled transactions, *i.e.*, to cleared bids) had been rendered inadequate due to the significant number of virtual bids now being placed in PJM's day ahead market. PJM noted that the majority of these bids do not clear the market and thus were not covered by PJM's prior credit requirements.

¹ See PJM Interconnection, L.L.C., 104 FERC ¶ 61,309 (2003) (September 22 Order). As noted below, PJM also submitted certain follow-up reports, as required by the September 22 Order, and responded to a Staff data request.

² Epic is the successor entity of Outback Power Marketing, Inc.

3. PJM stated that its revised credit requirements, as proposed in its initial filing, herein, were designed to cover these increased risks. Specifically, PJM proposed to assess new credit obligations on virtual bidders based on a participant's total volume of bids and offers.³ In the September 22 Order, we agreed with PJM that its then-existing credit requirements failed to adequately protect PJM's market participants from the default risks presented by entities that primarily engage in virtual bidding. However, we found that PJM had failed to support its reliance on an aggregated four-day period to determine a participant's virtual credit exposure. We held that the assessment period applicable to PJM's screens should not exceed two days (*i.e.*, the current day and the prior day) and questioned whether PJM's risk exposure may in fact be even less, *i.e.*, whether the two-day collateralization requirement we were accepting could be reduced to one day. Accordingly, we directed PJM, in a compliance filing, to either reduce its collateral requirement to one day, or explain why maintaining the collateral requirement for two full days is necessary.

4. We also addressed issues relating to a participant's allowed Working Credit Limit.⁴ We noted that permitting financial traders to utilize only 85 percent of their total collateral (PJM's existing requirement based on PJM's billing cycle and the added risk posed by a participant's ability to incur obligations for a certain period beyond the billing cycle) may no longer be reasonable as applied to virtual bidders. We therefore required PJM, in its compliance filing, to explain why financial assurance in the form of depository accounts or letters of credit, which meet PJM's requirements, should not be honored in the full amount.

5. With respect to the time period for holding and providing increased collateral, we noted that under PJM's proposal, any additional Financial Security provided by a participant would not be available for use until the second business day after confirmation of receipt and that any such additional security would be held by PJM for a minimum of three months. We found that these requirements could operate to inhibit financial traders' ability to submit bids on a single day even though they are willing to post the necessary collateral. Accordingly, we required PJM, in its compliance filing, to either modify these provisions or explain why they are necessary.

³ In doing so, PJM stated that it would first determine a participant's uncleared bid exposure for the prior four days of actual bids in order to determine whether virtual bid screening may be required. PJM stated that if virtual bid screening was required, it would reject all bids and offers submitted if the participant's available credit was exceeded by the participant's virtual credit exposure.

⁴ Under PJM's open access transmission tariff (PJM OATT), a participant's Working Credit Limit is calculated as 85 percent of the financial security provided by the Participant to PJM.

6. Finally, we addressed PJM's assertion that because the credit risks associated with virtual trading were still new and relatively uncertain, PJM's policy requirements would be subject to change. Given these anticipated changing circumstances, we required PJM to file with the Commission every six months for the next two years a report analyzing the effect on participants of its virtual bidding and collateralization requirements. We also required PJM to submit a 180-day report to explore whether additional changes should be made to PJM's settlement or credit procedures.

II. Request for Rehearing

7. Epic, *et al.* seek clarification, and in the alternative rehearing, on an issue which it claims was not expressly addressed by the Commission in the September 22 Order. Specifically, Epic, *et al.* seek clarification concerning PJM's calculation of "Credit Available for Virtual Bidding," a term which was defined by PJM, in its submittals, as a participant's "Working Credit Limit less its Total Net Obligations."⁵ Epic, *et al.* assert that under PJM's requirements, a participant's credit limits on daily bidding can decrease due to the participant's daily trading activities, while these same credit limits can never increase on a daily basis over the original posted amount even if PJM has a Net Obligation to the participant. Epic, *et al.* argue that a participant's credit limit should be allowed to increase on a daily basis based on market activity just as it decreases, even where this increase exceeds the amount of the original posted collateral.⁶

III. PJM's Compliance Filing

8. On October 7, 2003, in Docket No. ER03-1101-001, PJM submitted its compliance filing in response to our directives set forth in the September 22 Order. With respect to its virtual bid screening multiplier, PJM states that it has reduced its multiplier to two days, but that it is not in a position at this time to reduce this collateral requirement down to only one day. PJM states that, in fact, such a revision would require a comprehensive redesign of PJM's existing settlement system, which is the source of the information that is monitored by the credit department. PJM states, however, that it is

⁵ The term "Working Credit Limit" is discussed *supra* at note 4. "Total Net Obligation" is defined in the PJM OATT as the "unpaid prior month's Net Obligation plus the unbilled current month's Net Obligation incurred to date, as determined by PJM on a daily basis."

⁶ On November 12, 2003, PJM filed an answer to Epic, *et al.*'s rehearing request.

willing to investigate with its stakeholders the feasibility of such a revision and to report back to the Commission in its next follow-up report. PJM also submits an alternate proposal to the two day multiplier in its follow-up report.⁷

9. PJM also addresses its 85 percent standard applicable to its Working Credit Limit, noting that this standard generally should be retained because it is needed to cover PJM for additional days (beyond the billing cycle) that a defaulting participant could continue to incur obligations to PJM. However, PJM states that this additional coverage may not be required with respect to additional Financial Security provided by a virtual bidder because virtual bidders would be prevented by the screening process from incurring additional uncovered obligations.

10. PJM states that its compliance filing also provides an explanation, as required by the September 22 Order, for its requirement that additional Financial Security provided by a participant “will not be available for use until the second business day after confirmation of receipt and that such additional security must be maintained for a minimum of three months.” PJM states that this requirement should be generally retained because it reflects the practical timing realities in the receipt and confirmation of Financial Security. However, in order to make a participant’s collateral available as soon as reasonably possible, PJM proposes to revise and clarify the provision on Credit Available for Virtual Bidding as follows:

PJM will make a good faith effort to make new Financial Security available as Credit Available for Virtual Bidding as soon as practicable after confirmation of receipt. In any event, however, Financial Security received and confirmed by noon on a business day will be applied (as provided under this policy) to Credit Available for Virtual Bidding no later than 10:00 a.m. on the following business day. Receipt and acceptance of wired funds for cash deposit shall mean actual receipt by PJM’s bank, deposit into PJM’s customer deposit account, and confirmation by PJM Treasury that such wire has been received and deposited. Receipt and acceptance of letters of credit shall mean receipt of the original letter of credit or amendment thereto, and confirmation from PJM’s credit and legal staffs that such letter of credit or amendment thereto conforms to PJM’s requirements, which confirmation shall be made in a reasonable and practicable timeframe. To facilitate this process, bidders wiring funds for the purpose of increasing their Credit Available for Virtual Bidding are advised to specifically notify PJM treasury that a wire is being sent for such purpose.

11. Finally, PJM defends its requirement that posted collateral remain available for three months. PJM states that it is not able to establish, track, or maintain numerous

⁷ See section IV, below.

extremely short-term collateral accounts and that its current procedures (allowing for a hold period of a single calendar quarter) offers reasonable flexibility for virtual bidders.

12. Notice of PJM's compliance filing was published in the *Federal Register*,⁸ with interventions and protests due on or before October 28, 2003. A protest was timely filed by Epic, *et al.* In their protest, Epic, *et al.* object to PJM's determination that a one-day collateral requirement cannot be implemented at this time. Specifically, Epic, *et al.* assert that PJM's only support for its position (that a one-day requirement would necessitate changes to market settlement procedures) confuses the time required to calculate market settlements with the time required to determine credit requirements. Epic, *et al.* argue that while it may take PJM several days to calculate financial settlements for payment purposes, this process has no necessary bearing on PJM's credit calculations, because each of the inputs required to determine PJM's credit risk exposure are identifiable and, in fact, known on a daily basis.

13. Epic, *et al.* also take issue with PJM's limited revision to its 85 percent discount standard applicable to a participant's Working Credit Limit, noting that while PJM's proposal to treat additional Financial Security posted by a financial marketer as equal to 100 percent of the amount provided is appropriate, it fails to explain why this same allowance could not be extended to a participant's initial credit balance. Epic, *et al.* also take issue with PJM's proposed revision to its provision on Credit Available for Virtual Bidding. Epic, *et al.* assert that under the revised language, PJM could take as long as it wanted to credit a participant's account such that the promise of next day crediting could be illusory. Finally, Epic, *et al.* renew their objection to PJM's policy of holding posted collateral for a three-month period for any participant either exiting the market altogether or reducing its trading activity (and thus its credit requirement). Epic, *et al.* argue that these funds can and should be returned to the participant on a more timely basis. Epic, *et al.* point out, for example, that in the New England Power Pool markets, refunds are generally made within one business day.⁹

IV. PJM's Follow-Up Reports

14. On March 22, 2004, in Docket No. ER03-1101-003, PJM made its 180-day follow-up report and its first six-month report, as required by the September 22 Order. In its consolidated submittal, PJM reports that it has referred to its stakeholder committees

⁸ 69 Fed. Reg. 111 (2003).

⁹ On November 12, 2003, PJM filed an answer to Epic, *et al.*'s protest.

straw proposals to (i) implement an accelerated settlement process; and (ii) further reduce its two-day multiplier in calculating a participant's risk exposure.¹⁰ PJM's states, however, that its stakeholder working committees failed to endorse either proposal.

15. As required by the September 22 Order, PJM's update report also identifies the existing level of financial trading activity in PJM's markets.¹¹ PJM also reports that since it implemented its new credit policy, PJM has not been required to suspend any virtual bidders, nor has it incurred any bad debts. Finally, PJM reports that its markets have experienced a high degree of convergence between locational marginal prices in the day-ahead and real-time markets, but that this level of convergence does not appear to be attributable to its revised credit policy.

16. PJM submitted a second six-month follow up report as required by the September 22 Order on September 22, 2004 in Docket No. ER03-1101-005. PJM states in this report that there has been no increase in the total incremental collateral posted as a result of the virtual bid screening rules, no virtual bidders have been suspended, and PJM has not incurred any bad debts. PJM further asserts that it continues to experience a high degree of convergence between locational marginal prices in the day-ahead and real-time markets and this convergence is not affected by implementation of the virtual bid screening rules. PJM submitted a supplement to the September 22, 2004 filing on September 29, 2004 in Docket No. ER03-1101-006.

17. PJM asserts in this supplemental filing that virtual bids decreased by 22 percent while the megawatt-hours in these bids increased by 8 percent. PJM further states that the number of cleared virtual bids, and the megawatt-hours in those bids, increased by over 15 percent and 18 percent, respectively. PJM believes that the decrease in the number of bids was influenced by other tariff changes that established limits and charges

¹⁰ PJM states that it proposed, as an alternative multiplier, the lesser of: (i) the current calculation of two days of uncleared bid exposure; and (ii) one day of uncleared exposure plus three days of net cleared exposure, *i.e.*, the difference between cleared virtual demand bids and cleared virtual supply bids.

¹¹ PJM reports that since its implementation of its revised credit policy, there has been little change in the virtual trading practices occurring in its markets, either in terms of bid volumes submitted or cleared. PJM states that comparing the four months after the October 1, 2003 implementation of its new credit procedures with the eleven months before that implementation, the average daily number of submitted bids was essentially unchanged. PJM adds, however, that the megawatt-hours associated with these bids declined slightly. PJM concludes that its new credit policy has not adversely affected virtual bidding in its markets.

on virtual bids submitted. Finally, PJM explains that a virtual bidder's megawatt-hours of bids can affect its financial exposure, because it will enter binding financial obligations to buy or sell such megawatt-hours if its bids are accepted.

18. Notice of PJM's March 22, 2004 follow-up report was published in the *Federal Register*,¹² with interventions and protests due on or before April 12, 2004. A motion to intervene was timely filed by Amerada Hess Corporation (Hess). In addition, a protest was timely filed by Epic, *et al.* In their protest, Epic, *et al.* renew their assertions, as noted above, and assert that the Commission cannot rely on PJM to voluntarily support the credit revisions necessary to fully accommodate their participation in PJM's markets. On April 27, 2004, PJM filed an answer to Epic, *et al.*'s protest and on May 3, 2004, Epic, *et al.* submitted an answer to PJM's answer.

19. Notice of PJM's September 22, 2004 follow-up report, as amended on September 29, 2004, was published in the *Federal Register*,¹³ with interventions and protests due on or before October 20, 2004. Epic, *et al.* filed a protest on October 13, 2004 that renews their assertions stated above and further states that the PJM statistics in the report show that PJM's credit policies are harming the financial trading sector. Epic, *et al.* also assert that the PJM credit screening process should be modified in order to ensure that a participant is removed from PJM's bid screening when and if the participant's market activity no longer warrants screening.

V. Staff's Data Request

20. On May 5, 2004, in Docket No. ER03-1101-004, Commission Staff issued a data request addressing certain issues raised by PJM's compliance filing and follow-up report. Among other things, Staff's data request required PJM to address the potential resource commitment required by PJM in order to permit implementation of a one-day collateral requirement. Staff's data request also required PJM to quantify the estimated reduction in total posted security for virtual bidding if a one-day collateral requirement were implemented.

21. On May 26, 2004, PJM filed its response. In its response, PJM states that it posts cleared results of the day-ahead energy market to the PJM web site on a daily basis. PJM also states that it needs two days of collateral to cover uncleared activity because its day-ahead and real-time settlements are fully integrated. PJM asserts that, as such, it is required to wait until it receives real-time market data (in some cases a three-day wait) before it can assess a customer's credit position.

¹² 69 Fed. Reg. 32,337 (2004).

¹³ *Id.* at 51,924.

22. Notice of PJM's data responses was published in the *Federal Register*,¹⁴ with interventions and protests due on or before June 15, 2004. A protest was timely filed by Epic, *et al.*, in which they renew their positions previously taken on the issues noted above.

VI. Discussion

A. Procedural Matters

23. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure,¹⁵ the timely unopposed motion to intervene submitted by Hess, in Docket No. ER03-1101-003, serves to make it a party to that proceeding. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure¹⁶ prohibits an answer to a protest and an answer to an answer, unless otherwise permitted by the decisional authority. We are not persuaded to accept the answers submitted in these proceedings by PJM and Epic, *et al.* and therefore will reject them.

B. Epic, et al.'s Rehearing Request

24. We will grant rehearing of the September 22 Order, as requested by Epic, *et al.* In the September 22 Order, we responded to Epic, *et al.*'s assertion that PJM's calculation of a participant's Credit Available for Virtual Bidding failed to take a proper accounting of all credits owed to the participant by PJM. In response, we noted that, in fact, the PJM OATT required PJM to reduce a participant's Net Obligations by the amounts PJM owed a participant.¹⁷

25. However, as Epic, *et al.*, correctly note in their rehearing request, a participant's Total Net Obligation, as defined by PJM, represents only one factor in the equation used by PJM to calculate a participant's Credit Available for Virtual Bidding. In fact, it is the participant's Working Credit Limit *less* its Total Net Obligation that determines the amount of credit available to a virtual bidder. Moreover, as currently interpreted by PJM, a participant's available credit can never exceed its posted collateral, even when the participant is a net seller whose gains in the market are held (until the end of the billing process) by PJM. In other words, while PJM will permit a participant's obligations, as of the transaction settlement, to increase that participant's recognized credit commitment, up

¹⁴ *Id.* at 42,157.

¹⁵ 18 C.F.R. § 385.214 (2004).

¹⁶ *Id.* at § 385.213(a)(2).

¹⁷ September 22 Order at P 35.

to the amount of the participant's posted collateral; monies due to a participant over and above this posted amount are simply ignored by PJM. We agree with Epic, *et al.* that PJM has failed to support this arbitrary cut off, particularly where, as here, PJM can identify with certainty the amounts it currently owes a participant. Accordingly, we will require PJM, in a compliance filing to be made within 30 days of the date of this order, to revise its tariff provisions, consistent with our ruling herein.

C. PJM's Compliance Filing

1. PJM's Use of a Multiplier in Calculating Its Credit Requirements

26. PJM asserts that a credit risk assessment based on only a one-day risk exposure is not feasible at this time (at least not without a design change to PJM's market procedures) because its financial settlement process involves a multi-day process.¹⁸ However, we agree, in part, with Epic, *et al.* that PJM has not adequately justified requiring two-days of collateral for uncleared bids. PJM concedes that its uncleared bid exposure is known and, in fact, identified by PJM on a daily basis when it posts the results of the day-ahead market.¹⁹ As such, we see no valid reason for requiring participants to submit two days of collateral attributable to a virtual trader's uncleared bids.

27. However, we disagree that a risk assessment based on only a single day of uncleared bids and offers would adequately protect PJM against the risks attributable to a virtual trader's cleared bids and offers. The risk attributable to cleared bids exists up to the point that prices are determined in the real-time market. To address these added risks, PJM states that it has considered, as an alternative methodology, a modified risk assessment based on the lesser of: (i) the current calculation of two days of uncleared bid exposure; and (ii) one day of uncleared exposure plus three days of net cleared exposure, *i.e.*, the difference between cleared virtual demand bids and cleared virtual supply bids. We find this alternative methodology reasonable because it better balances PJM's exposure and reduces the collateral a virtual trader must post for uncleared bids. As PJM

¹⁸ PJM explains that because its settlement system is based on net energy billing, PJM cannot run the day-ahead energy settlements programs without the corresponding real-time market information. PJM states that, in addition, market participants are allowed until noon on the day after the operating day to enter their day-ahead market and real-time bilateral transactions into PJM's systems.

¹⁹ However, PJM asserts that results of the real-time market are not known until three days later and this time exposure factors into PJM's credit risk assessment since the day-ahead and real-time market screenings are integrated.

has explained, a large proportion of virtual traders' bids do not clear. As such, PJM's alternative methodology will reduce the need for excess collateral to cover these bids. Accordingly, we accept PJM's alternate proposal and will require PJM, in its compliance filing, to submit revised tariff sheets implementing this methodology.

2. Working Credit Limit and Retention of Posted Collateral

28. We will dismiss, as moot, Epic, *et al.*'s objections to PJM's initial proposals made in this proceeding to: (i) limit a financial marketers' Working Credit Limit to 85 percent of its original credit balance; and (ii) require that additional security posted by virtual bidders have a minimum three-month term. In a subsequent filing, submitted in Docket No. ER05-12-000, PJM proposed (and we have accepted) tariff revisions eliminating PJM's 85 percent credit requirement and revising credit retention policy, effective December 1, 2004.²⁰

3. Financial Security

29. We will accept PJM's alternative provision, as submitted in its compliance filing, regarding the use and availability of Financial Security by a participant following its receipt by PJM. PJM's initial proposal, as noted above, specified that any additional Financial Security provided by a participant would not become available for use until the second business day after confirmation of receipt. PJM's alternative provision, by contrast, gives the participant additional flexibility by requiring PJM to make a good faith effort to make this Financial Security available as soon as practicable following its receipt and allowing the participant's financial security to become available no later than the next business day if received by noon on the prior day.

30. While Epic, *et al.* object to this proposed provision as insufficient, Epic, *et al.* fail to offer any viable alternative that would both satisfy the needs of participants and address PJM's legitimate needs for collateral. Accordingly, we will accept PJM's alternative provision and require PJM to submit revised tariff sheets incorporating this provision into its OATT.

D. PJM's Follow-Up Reports

31. We will accept, in part, for informational purposes, and reject in part PJM's follow-up reports, as filed in this proceeding on March 22, 2004, September 22, 2004 and September 29, 2004. In its protests to these reports, Epic, *et al.* assert that PJM's data fails to include the relevant bidding activity, by participant. Epic, *et al.* argue that PJM,

²⁰ See PJM Interconnection, L.L.C., 109 FERC ¶ 61,241 (2004).

in order to comply with the Commission's compliance requirements, should have provided the number of bids submitted and cleared, along with the megawatt hours resulting from those bids, for financial traders subject to PJM's virtual bid screening process. We agree and therefore will require PJM to supply, along with the virtual bidding activity information already provided, the number of bidders at issue for the relevant months both before and after its virtual credits policies were implemented. In addition, we will require PJM to provide accurate data on the total amount of collateral that virtual traders are required to post. Finally, we will require PJM to clarify the data submitted in its September 29, 2004 report, in the chart entitled "Average Daily Virtual Bidding Activity by Month." As Epic, *et al.* correctly note, the number of bids cleared for the three months listed (May, July, and August of 2004) exceed the number of bids submitted.

The Commission orders:

(A) Epic, *et al.*'s request for rehearing is granted and its clarification request is hereby dismissed as moot, as discussed in the body of this order.

(B) Subject to Ordering Paragraph (D), PJM's compliance filing is hereby conditionally accepted, as discussed in the body of this order, effective September 20, 2003, as requested.

(C) PJM's follow-up reports are hereby accepted, in part, and rejected, in part, as discussed in the body of this order.

(D) PJM is hereby order to submit a compliance filing within 30 days of the date of this order reflecting modifications discussed in the body of this order.

By the Commission.

(S E A L)

Magalie R. Salas,
Secretary.